

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

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TO SECSTATE WASHDC 4468

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AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652:N/A

TAGS: ECON, UK

SUBJECT: UNION CHIEF PROPOSES NEW INVESTMENT FUND

1. SUMMARY. TRANSPORT UNION CHIEF JACK JONES HAS PUT FORWARD A GENERAL OUTLINE OF A SCHEME TO CHANNEL BOTH CORPORATE AND INSTITUTIONAL LIQUIDITY AWAY FROM FINANCIAL ASSETS AND INTO NEW INVESTMENT PROJECTS. THE IDEA CENTERS ON THE CREATION OF A NEW FUND BASED ON CONTRIBUTIONS EXTRACTED FROM INDIVIDUAL FIRMS AND INSTITUTIONAL INVESTORS

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AS WELL AS A SHARE OF TAX REVENUES PAID IN BY COR-

PORATIONS. OPERATING WITHIN THE NEW FRAMEWORK CONSISTING OF THE NATIONAL ENTERPRISE BOARD AND THE PROPOSED NETWORK OF PLANNING AGREEMENTS BETWEEN THE GOVERNMENT AND MAJOR INDUSTRIAL CORPORATIONS, THE FUND WOULD RELEASE RESOURCES FOR PROJECTS WHOSE RATE OF RETURN WAS NOT SUFFICIENT TO ATTRACT PRIVATE CAPITAL. REACTION HAS BEEN MUTED, BUT THE IDEA IS IN KEEPING WITH THE TREND TOWARD A LARGER GOVERNMENT ROLE IN PRIVATE INDUSTRY. END SUMMARY.

2. THE PROPOSAL MADE BY JONES WAS DEVELOPED BY OXFORD ECONOMIST JOHN HUGHES WHO DREW HEAVILY ON THE EXPERIENCE IN SWEDEN WHERE SUCH AN INVESTMENT FUND HAS BEEN OPERATING FOR SOME THIRTY YEARS. AS EXPLAINED IN THE PRESS, THE SWEDISH FUND OPERATES IN A COUNTER-CYCLICAL MANNER. AT THE PEAK OF THE CYCLE COMPANIES ARE INDUCED TO MAKE VOLUNTARY CONTRIBUTIONS TO THE FUND BY A PROVISION WHICH ALLOWS THEM TO AVOID TAXATION ON SUCH CONTRIBUTIONS. DURING PERIODS OF DECLINE, RESOURCES ARE RELEASED TO PERMIT THE UNDERTAKING OF PROJECTS SHELVED DURING THE EXPANSIONARY PHASE.

3. JACK JONES SUBMITTED A DRAFT OF HIS PROPOSAL TO THE CHANCELLOR LAST SPRING ASKING FOR HM TREASURY'S VIEWS. HE SAID THAT THE SCHEME WOULD PERMIT THE MOBILIZATION OF CAPITAL BY CHANNELLING CORPORATE AND INSTITUTIONAL RESOURCES AWAY FROM SPECULATIVE INVESTMENTS IN LAND AND COMMODITIES OR EVEN FROM SHORT TERM GOVERNMENT PAPER AND INTO BRICK AND MORTAR PROJECTS DESIGNED TO PROVIDE ADDITIONAL INVESTMENT AND EMPLOYMENT IN BRITISH INDUSTRY.

4. FEW DETAILS OF THE SCHEME HAVE EMERGED. FROM THE AVAILABLE EVIDENCE, IT APPEARS THAT AN INVESTMENT FUND OF 1.3 BILLION POUNDS IS ENVISAGED. INITIALLY THE MONEY WOULD COME FROM AN EARMARKING OF 20 PERCENT OF 1975 CORPORATE INCOME TAX PAYMENTS, A REDUCTION OF 30 PERCENT IN THE PRESENT RELIEF PROVIDED CORPORATIONS TO DEFER TAXATION OF INVENTORY PROFITS, AND A PROVISION THAT FIRMS DIVERT TO THE FUND 10 PERCENT OF STATUTORY DEPRECIATION ALLOWANCES. ADDITIONALLY, 500 MILLION POUNDS WOULD BE LIMITED OFFICIAL USE

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SOUGHT FROM INSTITUTIONAL INVESTORS SUCH AS PENSION FUNDS AND INSURANCE COMPANIES TO FINANCE INDUSTRIAL INVESTMENT PROJECTS.

5. THE FUND IS LIKELY TO BE A PUBLIC OR SEMI-PUBLIC INSTITUTION. IT WOULD RECEIVE APPLICATIONS FROM FIRMS WISHING TO DRAW FUNDS FOR SPECIFIC INVESTMENT PROJECTS AND WOULD MAKE DISBURSEMENTS FOR ACCEPTABLE PROPOSALS. FIRMS

NOT APPLYING FOR FUNDS WOULD BE PENALIZED BY NOT RECEIVING INTEREST ON MONIES THEY PAID IN.

6. COMMENT: WHILE THE JONES PROPOSAL IS PATTERNED ON THE SWEDISH MODEL, ITS INTENT DOES NOT APPEAR TO BE COUNTER CYCLICAL. IT AIMS AT A CONTINUING INJECTION OF RESOURCES INTO INDUSTRY UNDER SOME FORM OF PUBLIC GUIDANCE.

7. IN THE PRESENT ECONOMIC CONTEXT, EARMARKED TAX REVENUES WOULD INCREASE THE PUBLIC DEFICIT SINCE THE GOVERNMENT WOULD HAVE TO BORROW TO REPLACE THE DIVERTED RESOURCES. MOREOVER, CORPORATE LIQUIDITY, ONLY RECENTLY

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IMPROVED AFTER STRENUOUS GOVERNMENT EFFORTS, WOULD AGAIN COME UNDER PRESSURE. REDUCING DEPRECIATION ALLOWANCES APPEARS TO IMPLY SOME LOSS IN FIRMS' ABILITY TO REPLACE EXISTING CAPITAL GOODS, WHILE RESTORING A DEGREE OF TAXATION ON INVENTORY PROFITS FURTHER ERODES CASH FLOW. MOST SIGNIFICANTLY, THE FUND'S MANDATE SEEMS AIMED AT THE FINANCING OF PROJECTS WHOSE RATE OF RETURN IS BELOW THAT NEEDED TO ATTRACT PRIVATE CAPITAL. THIS WOULD RESULT IN AN INEFFICIENT ALLOCATION OF RESOURCES, THE COST OF WHICH WOULD BE BORNE BY OWNERS OF CORPORATE EQUITY WHO INCLUDE LIMITED OFFICIAL USE

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THE UP TO 14 MILLION PARTICIPANTS IN PENSION FUNDS AND HOLDERS OF LIFE INSURANCE POLICIES.

8. WITH INVESTMENT IN MANUFACTURING SHOWING EVERY SIGN OF DROPPING BY AS MUCH AS 15 PERCENT DURING 1975, AND THE UNIONS COOPERATING WITH THE GOVERNMENT'S ANTI-INFLATION POLICY, A PROPOSAL SUCH AS THIS COMING FROM A LEADER OF JACK JONES' STATURE CARRIES CONSIDERABLE WEIGHT. THE GOVERNMENT CANNOT AFFORD TO DISMISS IT OUT OF HAND, BUT THERE HAS NOT YET BEEN ANY OFFICIAL REACTION FROM HM TREASURY TO THE JONES PROPOSAL. THE PRESS HAS REPORTED REACTION AT THE GOVERNMENT WORKING LEVEL AS HOSTILE, WITH PRINCIPAL CRITICISMS OF THE SCHEME DEALING WITH LIKELY DISTORTIONS IN CASH FLOWS, CAPITAL MARKETS, AND THE REPLACEMENT OF EXISTING GOVERNMENT INVESTMENT INCENTIVE PROGRAMS. A SOURCE AT HM TREASURY TELLS US THAT THEY ARE HESITANT RATHER THAN HOSTILE, THE LATTER TERM USED BY JONES TO CHARACTERIZE THE TREASURY REACTION. NEVERTHELESS, IT SEEMS LIKELY THAT CAUTION WILL DOMINATE ANY RESPONSE BY THE CHANCELLOR. HE IS APT TO CALL FOR FURTHER STUDY OF WHAT AFTER ALL WOULD BE A RADICAL CHANGE IN THE WAY INVESTMENT IS UNDERTAKEN IN BRITAIN.

9. THE CONFEDERATION OF BRITISH INDUSTRY (CBI) HAS BEEN PURPOSEFULLY SILENT ON THE JONES PROPOSAL. WE ARE TOLD THAT CBI IS TRYING TO GET FURTHER DETAILS ON THE SCHEME: HOWEVER, THEY ARE HOPING THAT IT WILL TURN OUT TO BE ABORTIVE AND NO COMMENT WILL BE NECESSARY. CBI IS CURRENTLY HOLDING A SERIES OF DISCUSSIONS WITH CORPORATE FINANCIAL MANAGERS WHO ARE VERY PESSIMISTIC ABOUT THE NEAR TERM OUTLOOK GIVEN THE DEPRESSED LEVELS OF DEMAND IN THE UK AND THE REST OF THE EEC. WHILE THEIR LIQUIDITY POSITION HAS IMPROVED, THEY ARE NOT LIKELY TO PLACE THEIR AVAILABLE RESOURCES IN BRICK AND MORTAR PROJECTS, PREFER-

RING TO REMAIN MORE LIQUID UNTIL BUSINESS CONDITIONS SHOW
SIGNS OF IMPROVING. CLEARLY ANY ENFORCED REDUCTION IN
LIQUIDITY SUCH AS THAT INHERENT IN THE JONES PROPOSAL
WOULD ELICIT STRONG OPPOSITION FROM INDUSTRY.

10. THE JONES INITIATIVE IS YET ANOTHER IN THE LINE OF
PROPOSALS AIMED AT RECTIFYING CHRONICALLY LOW INVESTMENT
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IN BRITISH INDUSTRY. HOWEVER, SEEN IN THE CONTEXT OF THE
GROWING TREND TOWARD INDICATIVE PLANNING, SOME VARIANT
OF THE SCHEME, MODIFIED TO REMOVE SOME OF ITS MORE COM-
PULSORY ASPECTS, WILL LIKELY BE DISCUSSED AT OFFICIAL
LEVELS DURING THE COMING MONTHS. IN ANY EVENT, THIS IS
ONE MORE EXAMPLE OF UNION PRESSURE FOR A GROWING GOVERN-
MENT PRESENCE IN THE DECISION MAKING PROCESSES OF U.K.
INDUSTRY.

RICHARDSON

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